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Determinants of tax avoidance: Evidence from Indonesian mining industry

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Abstract

Tax avoidance is one of the company strategies to alleviate the company's tax burden by minimizing the amount of tax that must be paid legally. The mining sector is the most vulnerable sector to practice tax avoidance because this sector gains large profits from the mining activities carried out. This study aims to empirically examine the influences of executive incentive, corporate risk, corporate governance, and accounting conservatism on tax avoidance. The research population of this study was mining companies listed in the Indonesia Stock Exchange (IDX) from 2012 to 2017 as many as 41 companies. These research samples were 5 companies or 30 observation data selected by purposive sampling method. The data used is secondary data which is then analyzed using multiple regression. The result of the research showed that audit quality and accounting conservatism had negatively significant effects on tax avoidance. Meanwhile, executive incentive, corporate risk, institutional ownership, independent commissioners, and audit committee did not effect on tax avoidance.

Introduction

Tax avoidance is one of the company strategies to legally alleviate the company's tax burden. Tax avoidance is commonly carried out because many corporate and personal taxpayers feel burdened by paying taxes. On the other hand, it is caused by the low awareness of taxpayers to comply with tax provisions (Putra & Osman, 2019). Regarding that, the taxpayers try to relieve the taxpaying burden by minimizing the payable amount of tax (Dewi & Sari, 2015). One of the sectors which frequently conducts tax avoidance is the mining sector. With the abundance of natural resources, the mining sector is vulnerable to practice tax avoidance due to the large profit which can be gained from the mining activities.

Several tax avoidance cases occurring in Indonesia were perpetrated by mining corporates of Bakrie Group, namely PT Kaltim Prima Coal (KPC), PT Bumi Resources, andPT Arutmin Indonesia which was indicated of tax evasion amounting to Rp 2.1 trillion. According to the report of Directorate General of Taxation, the largest tax arrears belonged to PT KPC as much as Rp 1.5 trillion, followed by PT Bumi Resources amounting to Rp 376 billion and PT Arutmin Indonesia as much as Rp 300 billion. PT. Kaltim Prima Coal (PT. KPC) committed tax avoidance by practicing transfer pricing by selling the coal below the market price to the affiliated company (PT Indocoal Resource Limited). The price was only half the normal price which PT. KPC used to apply to other buyers. Then, PT Indocoal sold the coal to other buyers using the normal price regularly applied by KPC. As a result, the revenue of coal sales by PT. KPC was much lower and inflicted the country loss of as much as Rp 1.7 trillion.

Several factors are enabling a company of doing tax avoidance, including executive incentive, corporate risk, institutional ownership, independent commissioner, audit committee, audit quality, and accounting conservatism. The first factor, executive incentive, is closely related to the relationship between principal and agent. The incentive is given to merely increase the motivation of company executives to work optimally to reach the company goals. The executives have an important role in determining the direction and making policies of a company. The second factor, company risk, is a condition where there are a number of possibilities that are likely to cause company underperformance due to future insecurity (Dewi & Sari, 2015). Paligorova (2010) explained that company risk was a company earning volatility that could be measured using the formula of standard deviation. In other words, company risk is a standard deviation of a company's earnings, including both down risk and upsite potential. The bigger the earning deviation of a company, the bigger the company risk. The higher rate of company risk tends to lead to tax avoidance. Thus, the higher the rate of company risk, the lower the rate of tax payment compliance.

The third factor is corporate governance. The implementation of corporate governance is to minimize the conflict among agents. According to the National Committee of Governance Policy (KNKG), good corporate governance (GCG) mechanisms involve institutional ownership, proportion of board of commissioners, audit committee, and audit quality. Institutional ownership is company stock ownership by an institution. The stock ownership by institutional investors will enable supervision toward the insider performance (Jensen & Meckling, 1976). If it is related to tax avoidance, the higher level of institutional ownership will intensify the supervision. The intensive supervision will certainly prevent tax avoidance by the management. Next, the board of commissioners is one of the boards related to the contents of profit information of a company. The composition of the board of commissioners can influence the management in composing the financial statements to minimize tax avoidance. Another factor is the audit committee which has an important role to connect with the shareholders. The important task of the audit committee is monitoring the policies made by a company in financial reporting. Therefore, the optimal work of audit company is able to reduce tax avoidance behavior. In addition, there is audit quality which comprises the processes to reduce the information gap between management and shareholders by employing the third party to validate the company's financial statements. In auditing world, Big Four is widely known to have good world reputation. In accordance with tax avoidance, it can be assumed that a company audited by Big Four will strive to be transparent and will be difficult to manipulate the financial statements related to tax.

The fourth factor is accounting conservatism. According to FASB Statement of Concept No.2, conservatism is a cautious reaction to facing the predicted business uncertainty and risks in the future. If it is associated with tax avoidance, the practice of accounting conservatism will affect the financial reporting system which involves various policies; one of which is related to the company tax payment.

Based on the above explanation, this study aims to examine the influences of executive incentive, corporate risk*,* institutional ownership, independent commissioner, audit committee, audit quality, and accounting conservationism on tax avoidance. This research took six years from 2012 to 2017, and it is expected to give a contribution in order that the government can closely monitor the companies in fulfilling their taxation obligation.

Literature Review

Agency Theory

Agency theory focuses on the facts which are developing in every individual organization called 'agent' which acts as a party trusted in by another individual or group of individuals called 'principal'. The proponents of this theory assume that both principal and agent have their interests which frequently inflict divergence of interest between them (Lukviarman, 2016)

Agency theory mentions that the information asymmetry between manager and shareholders might result from the fact that the manager knows the company's internal conditions better than the shareholders. The manager has more motivation to meet his interest, so do the shareholders who are determined to create prosperity. This results in a conflict of interest which then creates agency cost. One of the ways to hold down or reduce the agency cost is clear description of organizational structure to establish an efficient system to govern the cooperation between agent and principal.

Executive Incentive on Tax Avoidance

An executive incentive is a form of reward given by a corporate to its executives in order to be more motivated in managing the corporation to reach the designated goals. The executive incentive is closely related to agency theory. Executive incentives are expected to make the executive (agent) focused on the achievement of the company goals and refrain from adverse acts which will disadvantage the company, such as tax avoidance. The research conducted by Sarra et al. (2014) revealed that executive incentives negatively affected tax avoidance. Based on the elaboration, the first hypothesis of this study is formulated as follows.
H_1: Executive incentive negatively affects tax avoidance.

Corporate Risk on Tax Avoidance

Tax avoidance conducted by a company through its policies is perpetrated by the top management or executives of the company itself where the top management of the company might have different characters. Different of interest impact the company to do tax avoidance. The higher the level of awareness owned by the taxpayers running business, the higher their level of compliance (Meidawati & Azmi, 2019). A company leader can be either a risk-taker of a risk-averse which is reflected in how big or small the company risks are (Budiman 2012). The different characters of the executives create different interests of theirs. Agency theory indicates that these interests may lead to future agency problems if there is an asymmetry of information between principal and agent on the policy should be implemented related to company risk. The company leaders certainly have an important role in the decision and policy making of the company. If it is associated with tax avoidance, the policy affected is the one related to the company tax avoidance rate. The more risks incurred by the company, the more unlikely the company perpetrates tax avoidance. The research done by Dewi and Jati (2014) showed that corporate risk positively affected tax avoidance. Based on the elaboration, the second hypothesis of this study is formulated as follows.
H_2: Corporate risk positively affects tax avoidance.

Institutional Ownership on Tax Avoidance

The proportion of stock ownership by institution will affect the quality of supervision toward management. Agency theory mentions that the more shares owned by institution, the stricter the supervision toward management behavior in a company (Winata, 2014). The high level of supervision will reduce the opportunistic behavior of the management, so it can prevent the management from making decisions related to tax avoidance. In his research, Suardana (2014) showed that institutional ownership negatively affected tax avoidance. Based on the description, the third hypothesis of this study is as follows.
H_3: Institutional ownership negatively affects tax avoidance.

Independent Commissioners on Tax Avoidance

Independent commissioner has the task and responsibility to exercise control and supervision functions toward company operations and ensures that corporate governance is implemented in the company. Agency theory claims that one of the ways to reduce the information asymmetry is by establishing a board of commissioners as the representative of shareholders. Therefore, the independent commissioner has a crucial role to oversee the company operations in order to adhere to the prevailing regulations and be able to detect deviation and fraud. With the existence of responsibility for the interest of public shareholders, the independent commissioner will defend

the company's tax compliance to prevent tax avoidance practices (Puspita & Harto, 2014), so that independent commissioners affect tax avoidance (Faradisty et al., 2019). The research by Suardana (2014) demonstrated that independent commissioners negatively affected tax avoidance. From the explanation above, the fourth hypothesis of this study is formulated as follows.
H_4: Independent commissioner negatively affects tax avoidance.

Audit Committee on Tax Avoidance

Audit Committee has tasks to conduct examinations on the composition of financial reporting and to do internal control in a company. Sandy and Lukviarman (2008) mentioned that audit committee must have existed in a company which implemented good corporate governance since its tasks were important for the company's life. Agency theory explains that agency problem can occur because of information asymmetry. Hence, the audit committee with good integrity and competence is needed to realize a good process of examination and supervision and minimize tax avoidance. Dewi and Jati (2014) assumed that audit committee negatively affected tax avoidance. Based on the elaboration, the fifth hypothesis of this study is formulated as follows.
H_5: Audit committee negatively affects tax avoidance.

Audit Quality on Tax Avoidance

Audit is an important component of corporate governance which is closely related to one of the corporate governance principles, namely transparency. Currently, public corporate demand more transparency in financial statements. A high level of transparency increases the investor interest to invest or buy stocks of the company (Winata, 2014). A qualified audit comes from an independent process and the high professionalism conducted by the expert auditor (Hamdani et al., 2020). In the auditing world, Big Four is widely known to have a good world reputation. In accordance with tax avoidance, it can be assumed that a company audited by Big Four will strive to be transparent and will be difficult to manipulate the financial statements related to tax. A study conducted by Sandy and Lukviarman (2008) revealed that audit quality negatively affected tax avoidance. Thus, based on the description above, the sixth hypothesis of this study is as follows.
H_6: Audit quality negatively affects tax avoidance.

Accounting Conservatism on Tax Avoidance

According to FASB Statement of Concept No.2, conservatism is a cautious reaction to facing the predicted business uncertainty and risks in the future. In Agency theory, conservatism has the most efficient role to limit agency conflict. In doing its activities, an agent generally tends to improve its welfare. Conservatism can prevent information asymmetry by limiting the agent in order not to manipulate the financial statements. Sarra et al. (2014) conducted a study that showed that accounting conservatism negatively affects tax avoidance. Based on the abovementioned description, the seventh hypothesis of this study is formulated as follows.
H_7: Accounting conservatism negatively affects tax avoidance.

Research Method

The approach used in this study was the quantitative research method. The research population was the mining companies listed in the Indonesia Stock Exchange of the period 2012-2017. The sampling technique was purposive sampling, and the sample used was 30 company samples. This study used secondary data in the forms of audited financial statements and annual reports of the companies which were obtained from the Indonesia Stock Exchange and IDX website. This study used dependent variables, namely tax avoidance, and independent variables including executive incentive, corporate risk, institutional ownership, independent commissioner, audit committee, audit quality, and accounting conservatism. Table 1 is the operational definitions of each variable.

Table 1. Operational Definition of Variables

Variable	Concept	Indicators
Tax avoidance (Gebhart, 2017)	An attempt which is performed by meeting all requirements of the prevailing taxation regulations and applying strategies of taxation	Total Book Tax Difference (BTD) = Pre-tax profit–(tax expense/tax rate)
Executive incentive (Armstrong et al., 2015)	One of the forms of reward given by shareholders to executives in order that the executives work congruently to the company goals (goal congruence). The executive incentive is given in the forms of salary, honorarium, allowance, and bonus or tantieme	$\frac{\text{Total executive incentives}}{\text{Company Sales}}$
Corporate risk (Paligorova, 2010)	A standard deviation of earning including both down risk and upsite potential	$RISK = \sqrt{\sum_{T-1}^{T}(E - 1/T\sum_{T-1}^{T} E)\ ^2/(T-1)}$
Institutional ownership (Khurana & Moser, 2010)	Stock ownership by the government, investors, debtors, banks, insurance companies, or investment companies excluding individual ownership	$\frac{\text{Total institutional stock ownership}}{\text{Number of shares issued}}$
Independent commissioner (Sandy dan Lukviarman 2008)	Independent commissioner has tasks and authorities to perform supervision on company operations. Independent commissioner does not have affiliation with any other party in the company. Independent commissioner must be able to maintain its independence in overseeing a company.	$\frac{\text{Number of independet commissioners}}{\text{Number of the board of commissioners}}$
Audit committee (Sarra et al., 2014)	Audit Committee has an important role and tasks in a company. The role is to examine and supervise all the activities during the financial reporting process and to perform internal control toward the company.	Total number of audit committee members in a company
Audit quality (Dewi and Sari 2015)	Audit quality is reflected from the audit process conducted by reputable Public Accountant Office (PAO) which applies transparency so that it is difficult to manipulate the financial statements related to tax.	Dummy variable (the company using Big Four service will be given 1 score, while the company using non-Big Four services will be given o score.
Accounting conservatism (Pramudito & Sari, 2015)	Conservatism is a cautious reaction in facing future business uncertainty and risks. Accounting conservatism can prevent information asymmetry by limiting an agent in doing manipulation in financial statements.	$\frac{\text{Non profit} - \text{operational cash flow}}{\text{Total asset}}$

Before hypothesis testing, the data were analyzed using 1) descriptive statistical analysis to describe the objects to be researched, and 2) classical assumption test to investigate whether or not the data met classical assumption. This was done to avoid biased estimation because not all data can be analyzed using regression. The classical assumption test involved the normality test, multicollinearity test, and heteroscedasticity test.

Result and Discussion

The data in this study were collected from the annual reports and financial statements of the mining companies listed on the Indonesia Stock Exchange between 2012 and 2017. Five companies were selected as the research samples, so the total sample used in this study was 30 samples. The selected samples were then used to analyze the data and to test the hypotheses. Descriptive statistical analysis is used to describe the variables of research statistically. This study used to mean, maximum value, minimum value, and standard deviation to describe the statistics of each variable. Based on the result of descriptive statistical analysis, executive incentive variable (X1) had a minimum value of 0.0002, the maximum value of 0.0393, average value of 0.010427, and standard deviation value as much as 0.115368. The corporate risk variable (X2) had a minimum value of 0.0002, the maximum value of 0.2496, the average value of 0.04113, and the standard deviation value amounting to 0.0596450. The institutional ownership variable (X3) had a minimum value of 0.3992, the maximum value of 0.6833, the average value of 0.5473329, and standard deviation value amounting to 0.1041738. The Independent commissioner variable (X4) had minimum value of 0.333, maximum value of0.5, average value of 0.36889, and standard deviation value as much as 0.0596450. Audit committee variable (X5) had a minimum value of 2, maximum value of 4, average value of 3.333, and standard deviation value of 0.66089. Audit quality variable (X6) had minimum value of 0 and maximum value of 1, average value of 0.6, and standard deviation value amounting to 0.49827. The variable of accounting conservatism (X7) had a minimum value amounting to -0.18719, the maximum value of 0.13516, average value of -0.0250411, and standard deviation of 0.07140444.

Classical Assumption Test

The normality test is to examine the normality of distribution of residuals variables in the regression model. Based on the result of the normality test, it can be concluded that the data used in this study were normally distributed and eligible for further research. The multicollinearity test is to investigate the correlations among independent variables in the regression model conducted. Based on the multicollinearity test, It can be then concluded that there was no correlation among independent variables in the regression model, and there was no multicollinearity among the independent variable in the regression model.

Based on the autocorrelation test, a run test was conducted and resulted in Asymp.Sig. (2-tailed) amounting to 0.139 which meant that there was no autocorrelation because of Asymp.Sig. (2-tailed) > 0.05. And the result of the heteroscedasticity test showed that the plots were distributed forming irregular patterns which could be concluded that this regression model was heteroscedastic so that the model was feasible to use.

Hypothesis Testing Result

To test the influences of executive incentive, corporate risk, institutional ownership, independent commissioner, audit committee, audit quality, and accounting conservatism on tax avoidance, double linear regression analysis was employed.

Based on Table 2, the influences of executive incentive, corporate risk, institutional ownership, independent commissioner, audit committee, audit quality, and accounting conservatism on tax avoidance were shown by Adjusted R Square value as much as 0.492 which meant that 49.2% of tax avoidance was influenced by executive incentive, corporate risk, institutional ownership, independent commissioner, audit committee, audit quality, and accounting conservatism, while the rest 51.8% was influenced by other variables which were not included in this study.

Table 2. Hypothesis Testing Result

Variable	B	t-score	Sig t	Description
(Constant)	3.434		.047	
Executive incentive	-3.960	-1.461	.158	Not Supported
Corporate risk	3.218	.627	.537	Not Supported
Institutional ownership	-3.133	-1.142	.266	Not Supported
Independent commissioner	-2.648	-.705	.488	Not Supported
Audit committee	1.754	.441	.664	Not Supported
Audit quality	-2.349	-3.815	.001	Supported
Accounting conservatism	-6.413	-2.087	.049	Supported
F-score	5.012			
Sig F	0.002			
Adj. R square	0.492			

Based on these results, it can be concluded that the first hypothesis (H1) is not supported, which means that executive incentive does not affect tax avoidance. This can be caused by the fact that there is no specific standard in Indonesia which can be used to regulate the amount of incentive. One company may have different regulations from another company on the incentive given to the executive. The amount of incentive given to the executive does not affect the work motivation of the executive and policy making including tax policy. Incentive or compensation system should be changed into share-based incentive which is deemed more effective to motivate the executive work in policy making. This research finding is in line with the research conducted by Dewi and Sari (2015) which revealed that executive incentives did not influence tax avoidance.

The second hypothesis (H2) is not supported. It means that corporate risk does not affect tax avoidance. The study of Paligorova (2010) assumed that scoring indicators could show the character of the executive of a company whether they were risk taker or risk averse. The character of the executives in this research was likely risk averse in which this character tends to be reluctant to take high risk. Consequently, in company management, the risk is minimum and does not affect tax avoidance. Therefore, the corporate risk does not affect tax avoidance. This result is supported by the research done by Butje (2014) which indicated that corporate risk did not influence tax avoidance. Nevertheless, this study finding opposed the research conducted by Dewi and Jati (2014) which showed that corporate risk positively affected tax avoidance.

The third hypothesis (H3) is not supported, which means that institutional ownership does not affect tax avoidance. Institutional ownership is not yet able to exert control on the management to prevent tax avoidance. This might result from the fact that the institutions which own the stocks trusted the supervision and management of the companies in the board of commissioners which might enable the act of tax avoidance by the management (Dewi & Sari, 2015). The result of the research performed by Sandy and Lukviarman (2008) and Dewi and Jati (2014) argued that institutional ownership did not influence tax avoidance. Yet, this research finding disagrees with the study conducted by Suardana (2014) which revealed that institutional ownership negatively affected tax avoidance.

The fourth hypothesis (H4) is not supported. Hence, an independent commissioner does not affect tax avoidance. The study done by Dewi and Jati (2014) indicated that independent commissioners did not strongly influence the policy making on tax avoidance. This might be caused by the fact that the information obtained by the independent commissioner is more limited than that owned by the management or company internals. Lack of knowledge on company business background will also affect the supervisory performance of independent commissioner which can result in the failure of the formulation of effective company strategies including taxation strategy. In their research, Dewi and Sari (2015) pointed out that independent commissioners did not influence tax avoidance. However, this result does not agree with the study conducted by Suardana, (2014) which declared that independent commissioners negatively influenced tax avoidance.

The fifth hypothesis (H5) is not supported. This means that audit committee does not influence tax avoidance. The audit committee has an important role and tasks in a company. The role of audit committee is to examine and supervise all activities during the process of financial reporting and internal control of the company. Nonetheless, if an audit committee stays for a long period in one particular company, it will affect the independence of the audit committee itself. The longer an audit committee stays in one company, the lower the credibility of independence it has. One of which is related to company tax reporting. This result is seconded by the study of Dewi and Sari (2015) which showed that audit committee did not affect tax avoidance. However, this study contradicts the research conducted by Dewi and Jati (2014) which revealed that audit committees negatively influenced tax avoidance.

The sixth hypothesis (H6) is supported. It means that audit quality significantly negatively affects tax avoidance. Audit is an important component of corporate governance which is closely related to one of the principles of corporate governance, namely transparency. Currently, the public company demands more transparency in financial statements. A high level of transparency also affects the investor interest in capital investment or to buy the stocks of a company (Winata, 2014). Qualified audit results from the independent process conducted by an expert auditor. As already mentioned, in the auditing world, Big Four is widely known to have a good world reputation. In accordance with tax avoidance, it can be assumed that a company audited by Big Four will strive to be transparent and will be difficult to manipulate the financial statements related to tax. This result is supported by the research carried out by (Sandy & Lukviarman, 2008) which argued that audit quality significantly negatively influenced tax avoidance.

The last result of this study showed that the seventh hypothesis (H7) is supported, which means that accounting conservatism significantly gives a negative influence on tax avoidance. Accounting conservatism, based on agency theory, has the benefit or most efficient role to limit agency conflict. In doing its activities, an agent generally tends to improve its welfare. Accounting conservatism can prevent information asymmetry by limiting the agent in order not to manipulate the financial statements. With the government regulations, the tendency to practice tax avoidance will be more difficult to do even though the company has chosen to use a conservative accounting method. Therefore, a company which applies accounting conservatism will show lower level of tax aggressiveness. The research carried out by Sarra et al. (2014) revealed that accounting conservatism negatively influenced tax avoidance.

Conclusion

Based on the discussion on the testings already conducted, this study has revealed that audit quality and accounting conservatism significantly negatively affect tax avoidance. Meanwhile, executive incentive, corporate risk, institutional ownership, independent commissioner, and audit committee do not influence tax avoidance.

This study has some limitations, those are: 1) this study only analyzed the companies in the mining sector as the research object. Further research is expected to expand to other sectors, such as banking; 2) This study generated a determination coefficient of as much as 49.2% which meant that 49.2% of tax avoidance determinants were influenced by executive incentive, corporate risk, institutional ownership, independent commissioner, audit committee, audit quality, and accounting conservatism, while the rest 51.8% was affected by other variables which were not included in this research model. It is expected that further research add other independent variables like CSR or political connection.

This research is to provide more considerations to the government to conduct stricter supervision to the companies related to their tax obligation and to give more severe punishment to the business actors who perpetrated illegal tax avoidance.

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